

**State Bar of South Dakota
Tax Update XXXII
Deduction for Dependents**

New "Families" Create New Problems
David Natvig
Natvig Law Office
natviglaw@midstatesd.net

Code Section

- Subsection (b) of § 151 concerns the personal exemption for the taxpayer and taxpayer's spouse.
- § 151 (c) allows additional personal exemptions for dependents.

- An individual is allowed to deduct an amount equal to the number of personal and dependency exemptions provided for that individual multiplied by the exemption amount.
- See [§151\(a\)](#); Regs. [§1.151-1\(a\)\(1\)](#)

Dependent

- Two Classifications:
 - A qualifying child
 - A qualifying relative

Even if a “child” does not satisfy the requirements of a qualifying child, the child may still be a qualifying relative. §152(d)(1)(D).

Qualifying Child

- Son, daughter, stepson, stepdaughter.
- Generally blood relatives but:
 - Adopted and foster children are treated the same as blood relatives. §152 (f)(1)(A)(ii)

BUT

- A descendent of a child or brother, sister, stepbrother or stepsister of the taxpayer OR their descendants are also treated as a child of the taxpayer. §152(c)(2)

Principal Place of Abode

- Must have been the same as the taxpayer for more than one-half of the year.
- Temporary absences from the "abode" for an education would not be treated as an absence by the service.

Age Requirements

- Under the age of 19 at the close of the calendar year in which the taxpayer's taxable year begins, or
- A student who has not attained age 24 at the end of such calendar year.
- Becomes permanently and totally disabled.

My own grandfather

- A child attains a particular age on the child's birthday, (Rev. Rul. 2003-72).
- A qualifying child must be younger than the taxpayer claiming such individual as a qualifying child.

Support

- The individual must not have provided more than one-half of his/her own support for the calendar year in which the taxable year of the taxpayer begins.
 - Includes clothing, meals, lodging and necessities.
 - Does not include the value of personal services rendered by the taxpayer.
 - Scholarships aren't considered, loans may be. (*P. McCauley v. Commissioner*, 56 T.C. 48 (1971))

Amounts provided by others

- Welfare payments are not considered support provided by the taxpayer, even if he is obligated to support the individual.
- Foster care payments received by the foster parents from the state are taken into account in determining if the foster parents provide more than half of the foster child's support.

Tie Breaker

- It is possible that a dependent may satisfy all of the qualifying child requirements for more than one taxpayer.
- The service provides a series of rules that apply when more than one taxpayer actually claims the same dependent.

A Tie goes to the:

- The rules break a tie by awarding the dependency status to the individual's parent, or if no one is a parent, to the taxpayer with the highest AGI for the year.
- If both taxpayers are parents, tie goes to the parent with whom the child resided with the longest, if that is a tie, to the parent with the highest AGI. §152(c)(4)(B).

Other Credits

- The child is a qualifying child of the selected taxpayer not only for the purposes of the dependency exemption deduction, but also
 - Child tax credit
 - Head of household filing status
 - Child and dependent care credit
 - Earned income credit.

Who's Child is this?

- It is impermissible for one taxpayer to claim the child as a qualifying child for dependency exemption deduction purposes and for another taxpayer to claim the child for other purposes.

- If two or more children are qualifying children with respect to two or more taxpayers, the taxpayers can choose to have one child be the qualifying child of one taxpayer for all purposes, the second child to be the qualifying child of the second taxpayer for all purposes.
– Notice 2006-86, 2006-41 I.R.B. 680.

Elderly Persons

- In the event several family members provide support, the code provides that those members may agree that one of the group will be treated as though he provided over half of the individual's support for the year.
§152(d)(3).
– Good luck with that one.

Citizenship

- Must be a citizen or national of the United States, or a resident of the US, or of a country contiguous to the US. §152(b)(3)(A).
- Does not apply to any child of the taxpayer legally adopted by the taxpayer. §152(b)(3)(B).

It's all relative

- Who are they?
- §152(d)(2)
- Child of the taxpayer
- Descendant of a child of the taxpayer
- Brother, sister (or stepsibling) of the taxpayer
- Father or Mother of the taxpayer
- An ancestor of the Father or Mother of the taxpayer

- Stepfather or Stepmother of the taxpayer
- Son or daughter of a brother or sister of the TP.
- Brother or sister of the father or mother of TP
- Son, daughter, father, mother, brother or sister IN LAW of the Taxpayer.
- An individual who meets the household test.

- When can a taxpayer's child, but not a qualifying child of the taxpayer, be a qualifying relative?

- When the child doesn't qualify because he or she doesn't satisfy the principal place of abode condition test or the age requirement condition.

Kidnapped Child

- A qualified kidnapped child is treated as a qualifying relative of the taxpayer
 - Kidnapped by a non-family member
 - Child must have been a qualifying relative of the taxpayer before the kidnapping.

Determination of a relationship

- A relationship established by affinity is not terminated by divorce or death of the spouse.
- If the relationship did not exist during the joint lifetime of the spouses, it can't come into existence later.

Examples

- H&W are married and file jointly. In 2006, H provides all support for W's sister, S and her husband T, both citizens with no income, both in their 50's.
- In 2006 W and S are killed in an accident, H provides 100% support for T.
- Can H claim a dependency exemption for T?

Example 2

- H and W marry in 2000 and file jointly. In 2003 W dies, in 2004, W's sister S marries T, a citizen who is 45 years old. In 2005 S Dies. In 2006 H provides all of the support for T, who has no gross income.
- Can H claim T as a qualifying child or relative?

Determination of Relationships

- A legally adopted child of an individual, or a person who is lawfully placed with an individual for legal adoption by the individual is treated as a child of the individual by blood.
– §152(f)(1)(B)

Example

- Is the cousin of the taxpayer's wife the taxpayer's sister-in-law merely because the cousin's parents informally adopted the taxpayer's wife?
- *Bidian v. Commissioner.*, 28 T.C.M. 747, 748(1969)

Child Tax Credit

- §24 There shall be allowed as a credit against the tax imposed by this chapter... with respect to each qualifying child of the taxpayer for which the taxpayer is allowed a deduction under §151 an amount equal to \$1000.00

Qualifying child

- A qualifying child of the taxpayer (as defined in §152(c) who has NOT attained age 17.
- Does not include any person who is not a citizen or national of the US unless that person is a resident of the US.

Divorce Inequity

- In the event the custodial parent executes a written waiver of the right to claim a dependency deduction for a child may result in neither parent being allowed to claim the child tax credit, since one parent has waived the right to claim and the non-custodial parent may not claim since the child did not live with that parent.

TIN requirement

- The IRS ruling that a taxpayer may claim the earning income credit on an amended return if a TIN is issued to the taxpayer's qualifying child after the close of the tax year "presumably" applies to the child tax credit.

Bankruptcy

- Is it reasonable to assume that the child tax credit, like the earned income credit, must be transferred to the taxpayer's trustee in bankruptcy, because it is property of the bankrupt's estate and is not exempt under state law as a public assistance benefit?
- See *In re Goertz*, 98-2150-572 (Bankr. W.D. Mo. 1996)

Household and Dependent Care Credit

- §21 Taxpayers for whom there are one or more qualifying individuals are allowed a credit for a portion of certain household and dependent care employment related expenses.

Conditions

- 1. The person is a dependent of the taxpayer by reason of being a qualified child of the taxpayer who has not attained age 13.
- 2. Is physically or mentally incapable of caring for him/her self and has same place of abode as taxpayer for more than one-half of the taxable year.

- 3. the person is the spouse of the taxpayer, is physically or mentally incapable of caring for him or her self and has the same place of abode as the taxpayer for more than one-half of the taxable year.

Example

- If T's 17 year-old dependent child, C, was capable of self-care until Oct. 3 2009 when C was injured in a parachute accident, does she qualify?

- Yes, only for the period of the injury through Dec. 31 2009.

Divorced or Separated Parents

- Special rule if the child satisfies two conditions:
 1. Custodial parent rules of §152(e) must apply to the child.
 2. The child must be either under the age of 13 or physically or mentally incapable of self-care.

• Under this rule the child is treated as a qualifying individual with respect to the custodial parent and is not treated as a qualifying child with respect to the noncustodial parent.
